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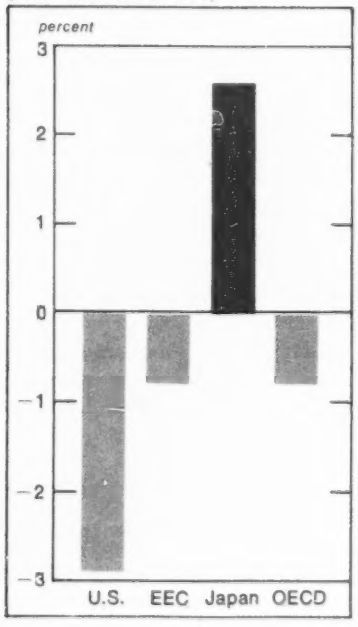
Growth Outlook for The World Economy

The outlook for the growth of the world economy over the next twelve months is increasingly bleak. Although output has held up to the oil price shocks better than anticipated, current evidence suggests that the industrialized world is entering a period of economic downturn that will be relatively synchronized across national economies and too severe to warrant the description "growth slowdown." There is no general agreement as to what is meant by the term "world recession," but the likely magnitude and degree of synchronization of the impending downturn are such that this term would seem to apply even though the downturn's dimensions are unlikely to match those of the global recession of 1974-75.

Selected real GNP growth estimates
(IVQ 1979 to IVQ 1980)



As was the case in 1974-75, the magnitude of the downturn will be more severe in the United States than elsewhere. The U.S. economy is now in a recession that may continue into the early months of 1981, with a peak-to-trough decline that appears likely to fall in the 3.5%-4.0% range. Since the oil price shocks hit the European economies during a period of relatively robust growth, the indirect deflationary effects of the OPEC price actions have been slower to develop there than in the United States. Nonetheless, the European economies are now slowing markedly, and growth in the EEC could turn negative as early as this summer. The dimensions of the downturn in Europe are less clear than in the United States, but, on current evidence, a peak-to-trough decline in EEC output of approximately 1.0%-1.5% would seem difficult to avoid. Of the major industrialized economies, only Japan appears unlikely to move into a technical recession. Barring a major disruption in Middle Eastern oil supplies, Japan should enjoy positive economic growth this year, albeit at a sharply reduced rate.

The common characteristic across economies of the impending downturn is a real decline in demand for consumption goods resulting from the sustained erosion of real personal disposable income. This common feature is also a major source of potential forecasting error, for consumer behavior is notoriously unstable. If consumers in Europe and Japan cling to past living standards as stubbornly as U.S. consumers have over the past year, the extent of synchronization of the downturn would be weakened and its peak-to-trough dimensions reduced. Much more likely, however, is a pattern of rising personal savings abroad. If this develops, a downturn of the proportions of a world recession would appear virtually inevitable.

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Swiss monetary policy remains tight, but relaxation is possible later in the year.

The Swiss economy looks set to enjoy sustained real growth into the second half of 1980, with surveys revealing a high degree of business confidence. GDP growth is expected to exceed 1.5% this year, compared with 0.7% in 1979. The strong growth, however, threatens to give Switzerland its first current-account deficit in 15 years. While inflation remains the chief concern, the outlook for prices has improved. Consumer prices rose at an annual rate of only 3.7% in the first four months of the year, although some acceleration is anticipated in the short run because of higher mortgage rates and a weak exchange rate in the first quarter. Accordingly, monetary policy will continue restrictive, and further substantial declines in interest rates are not expected before midyear. Thereafter, policy will be determined by the exchange-rate outlook, which is an encouraging one. The franc has already recovered by some 5% from less than 1.04 German marks earlier in the year. And if the dollar encounters additional downward pressure, some relaxation of German monetary policy will provide the scope for further appreciation of the Swiss franc and a rapid unwinding of interest rates later in the year.

Denmark's new economic package lacks punch.

An economic package presented to the Danish Parliament by Prime Minister Joergensen on May 7 has proven highly controversial. The package constitutes yet another attack on Denmark's chronic balance-of-payments deficit. It entails a further increase in the value-added tax (boosting it to 22%), together with additional taxes on electricity, fuel, oil, and gasoline, in addition to cuts in public spending. The goal is to keep the country's current-account deficit to about 16 billion kroner in 1980, reducing it steadily to achieve balance by the end of the decade. Critics note, however, that the package includes almost none of the tougher and politically sensitive measures—such as special taxes on property and autos, a tightening of eligibility rules for pensions, and a channeling of pension and insurance funds into industry—that were proposed in earlier negotiations. These same critics, which include the governor of the central bank, suggest that the package is so weak that further restrictions will be needed by autumn.

Israeli slowdown has eased inflation, but policy constraints are developing.

Evidence of an economic slowdown in Israel is increasing. The weakening is a response to the deflationary measures adopted toward the end of 1979. Credit curbs and limits on wage indexation agreements have led to real reductions in consumer spending, while industrial output is falling in almost all sectors of the economy. Consequently, real GDP growth is unlikely to reach the 2%-3% range officially forecast. The slowdown will have a positive impact on both inflation and the balance of payments in the medium term. Price increases are already in the range of 5%-7% per month, compared with 10%+ at the turn of the year. Nonetheless, inflation remains likely to average near 100% for the year as a whole. On the external-account front, declining import volume growth is being offset by higher oil prices, and the trade deficit is expected to continue to widen from its 1979 level of $4.1 billion. A policy conflict may emerge later in the year as the path toward economic equilibrium becomes more difficult. Specifically, the manufacturing industry and the export sector are being increasingly squeezed by adherence to strict deflationary measures, and unemployment is expected to rise from less than 4% as of end-1979 to some 5% by the end of this year.

New Zealand's economy in the doldrums.

Continued balance-of-payments deterioration coupled with rising inflation and weak domestic activity promise to keep New Zealand's economy in the doldrums in fiscal 1980/81, which began April 1. While public investment is likely to show some modest growth, private investment will continue to decline, owing to the Government's austerity policies. Industrial production is expected to advance about 3%-4%, compared with 2% growth in fiscal 1979/80, but agricultural output is likely to grow very little because of falling prices for wool, beef, and lamb. In addition, inflation looks set to rise from 14% last year to about 16%-17% this fiscal year as a result of large increases in wages and a rapid rate of money supply growth. Externally, the value of imports is projected to rise about 3% in real terms,

while export growth is expected to slacken. New Zealand's current-account deficit is thus forecast to remain in the $700-million range. Overall, real economic growth for fiscal 1980/81 is forecast at about 0.5%-1.0%, only a slight improvement over last year's negative growth of 0.75%.

Argentina acts to stabilize its financial markets.

Argentina has made progress in reducing its high inflation rate and strengthening its balance of payments. The consumer price index through April 1980 dropped to an annual rate of 118%, down from 157% a year earlier. And booming grain exports have helped boost international reserves to nearly $10 billion in March, 133% above their March 1979 level. Real GDP grew 8.5% in 1979, and while a similarly high rate will not be repeated this year, growth of 3%-4% is possible. Nonetheless, problems have arisen in the banking sector. Three Argentine-owned banks have been placed under central bank guidance because of questionable managerial and lending procedures. The central bank has also had to increase its level of deposit guarantees substantially. Coupled with the economy's underlying strength, however, these measures should be sufficient to limit the stress in the financial sector and preserve banking soundness.

Honduran economy on an expansionary course.

The Honduran economy has been the most dynamic in Central America, a result of its government's commitment to spurring economic and social development. In recent years, the authorities have introduced comprehensive agrarian reform and have increased spending on social and physical infrastructure. The country is planning to exploit its vast forestry resources and is constructing a large hydroelectric dam, which should more than double Honduras' electrical-generating capacity and reduce the need for costly fuel imports. Economic growth has averaged 7.5% annually since 1975, a rate unmatched in the region, and government resolve to continue with its development plan should ensure growth in the 6%-7% range over the next few years. The expansionary nature of government programs, however, has helped widen the current-account deficit, pushing it to some 9% of GDP by 1978-79. The current-account gaps have been financed primarily with borrowings from multi- and bilateral lending institutions at concessionary terms, rather than through reserve depletion or commercial bank borrowing. As a result, Honduras' debt structure is not an ominous one, and the debt-service ratio stands at a manageable 10%.

Qatar's current-account surplus doubled in 1979.

The emirate of Qatar, an OPEC member whose crude oil output accounts for nearly all its export revenues, registered a current-account surplus of $1.7 billion in 1979, double the $850-million positive balance posted in 1978. Only a small part of this improvement, however, is attributable to last year's 4% rise in production (to 506,000 barrels per day). The major factor was the 50% jump in Qatar's weighted average official oil export price to $19.59 per barrel, which boosted net oil revenues to an estimated $3.3 billion. Such a steep rise far more than offsets the increase in imports of goods, net services, and transfer payments to approximately $1.6 billion. In 1980, the current-account surplus is projected to nearly double again. Official oil prices this year will probably average at least $30 per barrel, generating net oil earnings of about $4.9 billion. And even with a 22% rise in current-account outflows to $2 billion, the resulting surplus would be about $2.9 billion.

Tea prices may ease slightly through year-end.

Monsoon rains have brought relief to the drought-stricken tea-growing regions of Southern India, Sri Lanka, and Kenya. As a result, world tea prices should ease over the remainder of 1980. Dry weather in the prime tea-producing areas in the early months of the year helped push average tea prices to a peak of near $1.06 per pound in February, their highest level since March 1978. However, with the world tea harvest now picking up, and with little change expected in the overall level of consumption, the U.S. Department of Agriculture projects that tea prices will average between $0.98 and $1.02 per pound over the remainder of the year. Preliminary estimates forecast total tea production for 1980 at 1,473,000 metric tons, roughly the same as in 1978 and 1979.

Total Private Credit Demands to Slow

Private nonfinancial credit-market borrowing in the first quarter of 1980 rose sharply, according to just-released flow-of-funds data. The increase came mostly from the corporate sector. While some of the rise in corporate funds raised apparently reflected anticipatory borrowing spurred by fears of a credit crunch, it also reflected a widening gap between capital expenditures and internally generated funds. This "financing gap" will probably remain wide over the next few months, since corporate profits usually fall faster than capital expenditures in the early stages of a recession. Consequently, total corporate credit demands should remain relatively strong for the next few months. Significant weaknesses in consumer and mortgage credit demands, however, should cause total private credit demands in the near term to slow.

Total credit market funds raised by nonfinancial corporations in the first quarter were $125 billion on a seasonally adjusted annual basis, up from $89 billion in the fourth quarter of 1979. Capital expenditures outpaced internally generated funds by an annual rate of $76 billion, while the comparable financing gap in fourth-quarter 1979 was $62 billion.

Businesses also increased their holdings of liquid assets in the first quarter by a seasonally adjusted annual rate of $54 billion, compared with only $14 billion in the fourth quarter. One possible explanation for this extraordinary rise is that during the first quarter, and especially in late February and early March, fears emerged that the availability of credit would be curtailed severely. Businesses thus increased their liquidity positions in preparation for any such credit crunch.

No severe credit crunch materialized. However, the increase in corporate liquidity may offset to some extent the effect of any increase in the financing gap on total credit-market borrowing, as corporations reduce their rate of liquid-asset accumulation. This offset may be minimized around the mid-June tax date, however, since corporate balance sheet data suggest that June corporate tax payments will be quite large.

Even if total corporate borrowing remains strong, weaknesses in credit-market borrowing by other sectors should more than offset any such strength. Recent data on housing starts, housing permits, and mortgage commitments all point to continued sluggish growth in mortgage credit over the next few months. And recent retrenchments in consumer spending patterns suggest that consumer credit growth has been falling sharply and may continue to slump in the near term. In fact, April and May figures for consumer instalment credit may show consumer credit outstanding actually declining in these months. In sum, total private credit demands should prove to be significantly weaker in the second quarter.

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1979		BALANCE
		3-months ending	change from year earlier	in billions of dollars	real growth	latest data
Austria	Inflation still rising, but real growth expected to decline to 2% from 5% in 1979.	Dec.	+ 7.6%	68.9	+ 5.3%	Mar.
Belgium	Economic growth forecast for 1980 revised down to 1.5%; inflation rate projected at 7%.	Dec.	+ 1.3%	111.5	+ 3.0%	Mar.
Britain	Unemployment rising rapidly as demand continues weakening and as wage increases reach 20%.	Jan.	+ 3.9%	391.2	+ 0.5%	Mar.
Denmark	New deflationary measures will produce virtually zero growth in 1980.	Jan.	+ 6.1%	65.6	+ 2.5%	Mar.
Finland	Economic growth of 4% expected in 1980, versus record 7.5% in 1979.	Dec.	+ 7.4%	41.6	+ 7.3%	Mar.
France	New industrial orders decline.	Jan.	+ 3.2%	566.9	+ 3.0%	Mar.
Germany	Economy still strong, with industrial output rising an annualized 5.3% in first quarter.	Feb.	+ 6.4%	755.8	+ 4.3%	Mar.
Ireland	Economic growth slowing in response to deflationary 1980 budget.	Sept.	+ 8.9%	14.9	+ 3.3%	Mar.
Italy	Industrial production sustains strong rise in first quarter.	Jan.	+ 7.7%	318.6	+ 4.0%	Mar.
Netherlands	Fiscal and incomes-policy tightening preclude any real economic growth this year.	Jan.	+ 0.3%	151.8	+ 3.3%	Mar.
Norway	The economy continues to grow rapidly, owing to oil.	Feb.	+ 1.7%	45.3	+ 2.8%	Mar.
Portugal	Government's desire to ease deflationary policy inhibited by renewed balance-of-payments deficit.	Oct.	+ 8.7%	20.2	+ 3.0%	Feb.
Spain	Outlook unfavorable, with unemployment rising and domestic economy virtually stagnant.	Sept.	0	197.4	+ 1.5%	Feb.
Sweden	Bitter labor disputes now resolved, with new settlements of some 7%.	Jan.	+ 8.0%	103.3	+ 4.0%	Mar.
Switzerland	Business outlook continues favorable.	Dec.	+ 4.0%	94.1	+ 0.3%	Mar.
Turkey	New one-year stand-by loan being negotiated with IMF; inflation rising from last year's 80%.	Nov.	0	66.1	+ 1.0%	Feb.
Canada	Industrial output decline in February presages overall output slowdown.	Jan.	+ 0.6%	222.8	+ 2.8%	Mar.
United States	Rising unemployment confirms economy in recession.	Apr.	0	2,349.0	+ 2.0%	Mar.

BALANCE			
reserves (less gold) in $ million	12-month change	months of imports covered	us cr lions
3,771	— 14.8%	2.2	
4,109	— 31.1%	0.8	
19,993	+ 12.2%	2.3	
1,839	— 56.2%	1.2	
1,672	+ 14.0%	1.6	
21,065	+ 38.9%	2.3	
46,217	— 5.4%	3.3	
2,035	— 16.8%	2.3	
19,168	+ 18.2%	3.0	
8,484	+ 9.4%	1.5	
4,462	+ 21.5%	3.7	
814	+ 6.5%	1.6	
13,417	+ 31.7%	6.2	
3,375	— 11.4%	1.3	
13,483	— 19.0%	5.1	
825	+ 9.7%	2.0	
2,715	— 38.6%	0.6	
10,280	+ 1.0%	0.5	

Food Price Outlook Clouded

The struggle against inflation received an important psychological boost earlier this month with the report that the rate of increase in producer prices had slowed significantly in April. Thanks largely to a decline in the prices retailers pay for finished food products, the Producer Price Index (PPI) for finished goods rose only 0.5% last month. This was far less than the 1.3% average monthly increase for the previous nine months. The fall in wholesale food prices in April was a spectacular 2.8%, the steepest monthly drop since June 1974. It reflected sharp declines in the wholesale prices of beef, pork, and poultry.

Nevertheless, consumers are likely to be especially hard hit by higher meat prices in the second half of the year. High interest rates and the collapse of wholesale prices for poultry and livestock have cut into profits for producers of these animals. Pork and poultry producers, unable to cover their production costs, are rapidly trimming supplies. And the number of new beef cattle placed on feed in the first quarter of this year was the lowest since 1975.

These developments point to sharply reduced marketings of meat and poultry later in the year. Because these items account for more than one-third of consumers' home food budgets, some analysts are warning that soaring meat prices will push overall retail food price increases into double digits by year-end. Such pessimism, however, may not be warranted.

First of all, retail food prices depend on consumer demand as well as on supply-side influences. When purchasing power declines in a recession, consumers typically reduce their consumption of expensive meat products and substitute greater amounts of cheaper foods. This tends to limit increases in meat prices. The duration and severity of the current recession will thus determine the extent to which reduced demand will offset the supply-related upward pressures on meat prices.

Furthermore, the outlook for other components of the retail food price index is not as gloomy as for meat. To be sure, heavy rains in California earlier in the year and a late freeze in Florida have triggered some short-term increases in fresh vegetable prices. But barring unforeseen weather or harvest problems, supplies of most vegetable items are likely to be ample, with prices continuing below year-earlier levels.

For still other components, the outlook is mixed. Although production of dairy products is expected to continue increasing, prices will still be determined largely by government price-support policy. Sugar has been a highly volatile commodity this year, and shortfalls to date in foreign production are likely to push retail prices for refined sugar still higher.

Beyond the outlook for raw food prices, marketing costs will remain a major contributor to price rises throughout 1980. A slowing economy, however, may help moderate some of the increases in energy, labor, transport, and inventory financing costs that have contributed to rising food bills in the past.

OF PAYMENTS		MONEY AND BANKING							COUNTRIES
		12-month changes				central bank rate	exchange rate in U.S. dollars		
of IMF t, mil- dollars	current influences on payments	latest data	consumer prices	latest data	domestic credit	May 21, 1980		current monetary conditions	
0	Current-account gap 9.9 billion schillings in first quarter, versus 5 bn. in 1979.	Feb.	+ 5.4%	Jan.	+17.0%	6.75%	.0780	Monetary conditions remain restrictive.	Austria
0	More costly oil imports and weak exports widen trade gap.	Mar.	+ 6.5%	Dec.	+14.5%	14.00%	.0347	Interests rates ease slightly as pressure on franc subsides.	Belgium
0	Exports strong despite sterling's strength, but current account continues in deficit.	Apr.	+21.8%	Dec.	+22.6%	17.00%	2.3300	Loan demand unresponsive to high interest rates.	Britain
0	Current-account gap likely to reach 16 billion kroner in 1980.	Feb.	+13.3%	Oct.	+10.1%	13.00%	.1792	Credit conditions remain highly restrictive.	Denmark
83	First quarter current-account gap 762 million markkaa, vs. surplus year ago.	Mar.	+ 9.6%	Nov.	+17.4%	9.25%	.2708	Markkaa revalued 2% in March to check imported inflation.	Finland
0	Substantial current-account deficit expected this year.	Mar.	+13.7%	Aug.	+13.6%	9.50%	.2398	Firm-exchange-rate goal makes early rate decline unlikely.	France
0	Current-account deficit continues large; government borrows abroad.	Apr.	+ 5.7%	Jan.	+12.2%	7.50%	.5589	Interest rates raised further.	Germany
0	Trade deficit narrowing, but large current-account gap expected in 1980.	Feb.	+15.6%	Feb.	+24.4%	16.85%	2.0850	Interest rates exceptionally high.	Ireland
0	First-quarter trade gap 3.8 trillion lira, vs. lit. 74-billion gap year earlier.	Mar.	+21.3%	Nov.	+19.2%	15.00%	.001187	Interest rates to rise further.	Italy
0	Export volume expected to grow 1% in 1980; import volume to fall.	Feb.	+ 5.9%	Dec.	+17.2%	10.00%	.5075	Discount rate boosted.	Netherlands
0	Higher oil prices may yield first payments surplus since 1969.	Mar.	+ 8.5%	Oct.	+16.1%	9.00%	.2040	Government to retain tight money and credit policy.	Norway
38	Current-account gap of $875 mn. likely in 1980, vs. $150-mn. surplus in 1979.	Feb.	+22.7%	Dec.	+27.4%	17.00%	.0204	Monetary conditions remain restrictive.	Portugal
57	Current account firmly in deficit, following oil price rise.	Jan.	+16.8%	Feb.	+18.7%	8.00%	.0141	Large budget deficits leading to credit tightening.	Spain
0	Current-account deficit of about 17 billion kronor expected in 1980.	Mar.	+13.5%	Dec.	+18.6%	10.00%	.2375	Government extends temporary freeze on prices.	Sweden
0	Current-account deficit threatens.	Apr.	+ 4.1%	Jan.	+16.3%	3.00%	.6013	No early easing of credit conditions anticipated.	Switzerland
0	Oil imports boost first-quarter trade gap to $1 billion.	Dec.	+81.1%	Feb.	+14.4%	10.75%	.0135	Lira devalued further against mark, but not against dollar.	Turkey
0	Imports decline as business activity lags.	Apr.	+ 9.2%	Dec.	+22.6%	13.34%	.8620	Interests rates on downtrend.	Canada
0	Oil price hikes contribute to large first-quarter trade deficit.	Mar.	+14.7%	Apr.	+ 9.4%	13.00%	—	Money growth well below Federal Reserve targets.	United States

World Interest Rates

market rates of May 21, 1980; bond yields as of May 16, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	13.00	13.34	17.00	14.00	9.50	7.50	15.00 penalty rate 18.00	10.00	3.00	9.00
Day-to-Day Money	9.50 May 22	16.00	15.50	14.45	13.00	9.55	17.00	11.125	4.75	12.8125
Treasury Bills 91-day, Middle Rates	8.06	11.75	16.00	15.75	n. a.	n. a.	15.05 101-day	no dealing	no market	6.75 2-month
Commercial Paper prime, 3-month, asked	9.00 finance paper	12.125 finance paper 15% tax w/h	14.76	13.90 Certified	12.875 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	8.75	12.05 15% tax w/h	16.4375	15.25 Certified	not traded	9.90	18.50	no market	4.50 not traded	no market
Government Bonds Long-term, new and old issues, average yield	10.57	11.75	13.69	10.82 20% tax w/h	12.80	8.59	15.02	10.03	4.83	8.65
Industrial Bonds prime, long-term, new and old issues, average yield	11.25 Aa Industrials	12.125	14.42	14.49	14.09	8.78	14.95	10.98	5.74	7.51
Bank Short-Term Rate to Best Borrowers (prime rate)	15.50*	14.75	18.00	18.75	14.60	11.50	20.00	13.00	5.50	9.25
Bank Time Deposits 3-month	9.00 Cert. of Dep.	12.00 Cert. of Dep.	16.9375	16.00	12.875	10.00	10.75	11.375 large deposits	6.25 residents only	6.00 20% tax w/h
Eurocurrencies 3-month, asked	10.1875*	no market	17.625*	no market	13.00*	9.625*	no market	11.125*	10.0625*	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8620	2.3300	.03470	.2398	.5589	.001187	.5075	.6013	.004453
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	1.375 *D*	6.875 *D*	5.50 *D*	2.875 *D*	.875 *P*	6.875 *D*	1.00 *D*	4.375 *P*	2.75 *P*

Eurodollar Deposits
(London, interbank, bid)
May 22

7-day	8.625
1-month	9.8125
3-month	10.0625
6-month	10.0625

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	− .84
U.S.-Canada Treasury Bills	−1.80
U.S.-Canada Finance Co. Paper	−1.34
Eurodollars-U.K. Local Auth. Deposits	+ .31

Eurobonds**
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.25
Over 7 yrs.	11.625
DM Bonds	
7 yrs. and under	9.00
Over 7 yrs.	9.00

Gold Price
London afternoon fixing
513.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Market rates as of May 22. ** Rates as of May 14.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	14.7 (Mar.)	9.2 (Apr.)	21.8 (Apr.)	13.7 (Mar.)	5.7 (Apr.)	21.3 (Mar.)	4.1 (Apr.)	8.0 (Mar.)
Industrial production*	−1.5 (Apr.)	0.7 (Mar.)	−3.4 (Mar.)	3.0 (Mar.)	4.9 (Mar.)	7.0 (Mar.)	4.0 (Dec.)	11.6 (Mar.)
Trade balance† *(billions of local currency units)*	−$3.2 (Mar.)	C$.70 (Mar.)	−£.26 (Apr.)	−FF2.0 (Apr.)	DM2.0 (Mar.)	−Lit.384 (Mar.)	−SF1.26 (Apr.)	−¥267 (Apr.)
Money supply (M_1)*	3.8 (Apr.)	6.1 (Apr.)	5.9 (Mar.)	9.5 (Jan.)	−1.1 (Feb.)	25.5 (Nov.)	−12.5 (Feb.)	8.0 (Mar.)
Velocity of money (M_1)*	3.9 (Dec.)	12.2 (Dec.)	4.8 (Sept.)	11.1 (Sept.)	4.1 (Dec.)	−3.1 (June)	n. a.	3.8 (Dec.)
Reserves minus gold *($ million, change from previous month)*	608 (Mar.)	−756 (Mar.)	−563 (Mar.)	944 (Mar.)	−2,902 (Mar.)	169 (Mar.)	−183 (Mar.)	169 (Mar.)

* Percent change from 12 months earlier. † Figures are only for the month indicated

Greece Prepares for EEC Membership

The Greek economy is currently straddling the industrialized and developing worlds. Greece's 1978 per capita income of $3,400 is about half the European Economic Community (EEC) average and equivalent with that of Ireland. Yet manufacturing now accounts for about one-third of total output, and this proportion continues to increase.

Following the fall of the military dictatorship in 1974, the Government of Constantine Karamanlis pursued policies aimed at sustaining Greece's rapid economic growth, which had averaged some 7% per year between 1957 and 1973. And indeed, despite the 1973-74 oil price explosion, Greece's economy did manage to grow at an average annual rate of 4.8% in the 1975-79 period, compared with an EEC average of just 2.4%. Furthermore, until only recently rapid growth in earnings from exports and invisibles (particularly shipping, tourism, and worker remittances) held Greece's current-account deficits to manageable levels.

The rapid growth, however, eventually produced imbalances in the distribution of the national product. Wage increases, in particular, rose by some 25% per year between 1973 and 1978, while annual price increases were held to 16%. The resulting 9% average annual real wage growth far exceeded the growth in productivity (and was especially disturbing in view of the 3% annual deterioration in Greece's terms of trade). The fast wage growth led to a profit and investment squeeze, causing private manufacturing investment to decline over the 1974-79 period. It also set the stage for an acceleration in the inflation rate as profits could no longer absorb high labor costs. Moreover, the surge in private consumption triggered a balance-of-payments deterioration that was compounded in 1979 by another round of oil price increases.

Responding to these problems, the Greek authorities tightened monetary policy and introduced public spending cuts, mainly in investment. The public-sector borrowing requirement is provisionally estimated to have dropped from 5.1% of GDP in 1978 to 4% in 1979. Monetary growth also decelerated over the course of 1979, with year-over-year M_1 growth estimated to have fallen from 22% in 1978 to less than 16% last year.

The corrective policy measures adopted in mid-1979, however, came too late to halt a sharp deterioration in key economic indicators last year. While real GDP growth is estimated to have slowed to 3.9%, consumer prices at the end of 1979 were 24.5% above their end-1978 level, yielding an average inflation rate of 19% for the year. And the current-account deficit is estimated to have widened from $1.2 billion in 1978 to about $2.3 billion in 1979. Some $800 million of the current-account deterioration was the direct result of a higher oil bill. Net oil imports rose from $975 million in 1978 to $1.8 billion in 1979, reflecting a higher oil import volume and heavy spot market purchases.

At the same time, private capital inflows declined slightly in 1979, forcing an increased reliance on public loans, trade credits, commercial bank funding, and private borrowing to finance the current-account gap. Greece's total external debt (including expatriates' deposits) is estimated to have risen from $8 billion in 1978 to more than $10 billion, with the 1979 debt service equal to 21% of exports and to 10% of current-account earnings.

Late in 1979, the authorities took further actions in their battle against inflation and the balance-of-payments dislocation. Interest rates were boosted, and the Government announced that the public-sector deficit would be pared down further to 3.1% of GDP. Furthermore, a 75% six-month import deposit scheme and a 25% consumer tax—both on non-essential imports—were introduced. But most importantly, the authorities announced an incomes policy to hold wage increases to less than 18%.

Although the average inflation rate in 1980 is forecast to be about the same as in 1979—approximately 19%—the rate is expected to decline during the second half of the year. Private consumption is expected to show very little growth, and the volume of construction output looks set to decline by 10%. The current-account deficit, on the other hand, is likely to rise to $2.5 billion from $2.3 billion last year. This projection is based on the anticipation of a higher oil bill, however, and masks an estimated $450-million likely improvement in the non-oil current-account balance. The net effect of the Government's deflationary policies will be to cut real GDP growth to about 1.5% in 1980, well below earlier official forecasts.

On January 1, 1981, Greece will become the tenth member of the European Economic Community. Although the country has been an associate member for some time, with already very low industrial tariffs on EEC-country imports, it will still have to phase out substantial export subsidies to its industrial exporters. Membership will also require the eventual relaxation of capital controls and greater freedom of the domestic financial market. In the short run, EEC membership will have a beneficial impact on agricultural exports and will increase the likelihood of government-to-government balance-of-payments assistance from other EEC countries. Over the longer term, Greece's labor cost advantage and relatively advanced infrastructure should attract investment from other EEC partners. Furthermore, access to Community markets and the release of labor from an industrializing agricultural sector should sustain real average annual GDP growth of 4%-5% in the 1980s.

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The Nature of the Asiacurrency Market

The Asiacurrency market, just as its Eurocurrency precursor, was created by international banks seeking to overcome national barriers to international financial intermediation. Both offshore markets are aimed at satisfying the massive financial requirements of worldwide industrial development with maximum flexibility, using the U.S. dollar as a predominant transactions currency. The only real differences between the two markets are those of size and geography. But although the $38-billion Asiacurrency market is still in its early stages, compared with the trillion-dollar Euromarket, its impact on the Asian region it services is no less significant.

In addition to its function of financial intermediator between several Asian nations and the Eurocurrency market, Asiamarket participants arbitrage between financial markets in Asia, the Middle East, and Europe. The market is also an important conduit for channeling economic development funds into the Asia-Pacific area. But perhaps its greatest contribution is the substantial business cost savings made possible by its operation and geographic location.

The Asiamarket was launched in Singapore in 1968, a period marked by rapid industrialization and decolonization of Singapore's economic structure in the wake of independence from Great Britain. Complementing domestic industrial development was Singapore's expansion of its external financial and trade relations, which spurred the emergence of the Asiacurrency market. The market's development is integral to Singapore's strategy of stimulating the development of a large and sophisticated financial sector to serve the Asia-Pacific region, in addition to increasing the inflow of financial resources for domestic use.

To promote the development of the Asiacurrency market, the Monetary Authority of Singapore has sought to maximize the flexibility of its offshore currency market, insulating it from domestic financial market restrictions. Specific actions taken over the last 12 years have included exempting Asiamarket transactions from exchange controls, abolishing withholding and other taxes on non-residents' income on foreign-currency deposits, and eliminating minimum reserve requirements against foreign-currency deposits. In response, the number of banks operating in the Asiacurrency market—both foreign and domestic—rose from one in 1968 to 101 by the end of 1979.

The Monetary Authority has also taken steps to ensure responsible financial practices in the Asiamarket. The Banking Act of 1979, for example, requires foreign commercial banks to establish branches rather than subsidiaries in Singapore so that bank home offices bear the full risk of insolvency.

Singapore has also acted to protect its domestic banking industry from being squeezed out by Asiamarket banks. Full-service banking licenses have not been granted to foreign banks since the market's inception. And since 1973, foreign banks have been eligible only for offshore-banking licenses. Foreign banks are permitted to accept local funds only through the interbank market, and deposits from residents must be at least S$250,000. Their local lending is also restricted. The Government's basic objective is to limit non-domestic banks to those areas of local business that complement, rather than compete with, fully licensed local banks.

The development of the Asiamarket has also altered Singapore's traditional financial-market relationship with Hong Kong. Singapore's elimination of exchange controls and the reduced rate of taxation on income from offshore-banking activities (from 40% to 10% in 1973), accompanied by Hong Kong's imposition of a 17% corporate tax on bank offshore earnings, have elevated Singapore's status as a financial center to a level equal with that of Hong Kong. Hong Kong, however, retains the advantages of superior ancillary facilities, a laissez-faire environment, and close proximity to market information and participants. It thus appears likely that Hong Kong will continue to play the role of regional "deal maker," tapping the growing Asiacurrency market in Singapore for funding.

The suppliers and borrowers of Asiacurrency funds have changed significantly since 1968. In the early years, non-bank deposits accounted for more than two-thirds of total Asiamarket liabilities, while loans to the non-bank sector were less than 5% of total assets. Since then, mainly because of the international liquidity explosion of the post-OPEC period, interbank deposits have come to dominate market activities. Indeed, the proportion of deposits from the non-bank sector now accounts for only 15% of total liabilities. As for non-bank loans, these accounted for more than 22% of total assets in 1979. Non-bank borrowers have traditionally consisted of large regional and national companies. But since the OPEC price explosion of 1974, governments and their agencies have loomed large as borrowers. Moreover, since 1974 an increasingly larger portion of Asiamarket funds are used to finance energy-related activities.

The Asiacurrency market has already shown remarkable flexibility in adjusting to the post-OPEC world by innovating in response to the strains in the international payments system. And current economic trends--including the move toward monetary tightening in the West, the increasing internationalization of capital markets, and bright prospects for Asian economic expansion—promise continued growth for the Asiamarket in the 1980s.

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